

INTERNAL REVENUE SERVICE
P.O. BOX 2508
CINCINNATI, OH 45201

DEPARTMENT OF THE TREASURY

Person to Contact:

Contact Telephone Number:

Refer Reply to:

Date: DEC 13 2001

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

You incorporated in the [REDACTED] to purchase, operate and maintain a swimming pool, playground and recreational area in [REDACTED], for the use and benefit of the members of this association and their families and guests as hereinafter defined in this charter; to purchase real estate and equipment and to do any and all such other and further acts and things as are reasonably incidental to the carrying out of the aforesaid purposes.

[REDACTED]

You amended the Articles on February 2, 2000 to change the organization's membership. Article VIII (B) states, "There shall be two classes of members, the first class being designated as "regular members" and the second class being designated as "temporary members". The following provisions shall apply to each respective class of membership: a) the total number of regular members shall not exceed thirty-one (31). All of the voting power and voting rights shall be vested in the regular members thereof. ...[sic]"

"The total number of temporary member shall be set forth in the Bylaws. The temporary members shall have no voting rights. The temporary members shall not be issued a certificate of membership. The annual dues of temporary members shall be established annually by the board of directors. The dues of the temporary members shall not necessarily be the same as the dues of the regular members".

The Bylaws adopted on December 1, 1999 states in Article I (A), that there are 28 regular members. Paragraph (C) states, temporary members shall have no voting rights in the corporation, shall not constitute a part of any quorum and shall have no rights or privileges other than those specifically granted upon their election and as set forth in the charter and bylaws. It also states, temporary members shall be subject to such dues as may be imposed by the Board of Directors of this corporation regardless of whether they are for the same amount as required of the regular members or not. The total number of temporary members shall not exceed forty (40).

The original directors/officers of the organization were [REDACTED]. The membership of the organization consisted of said individuals [REDACTED]. In addition, [REDACTED] permanent member.

In letter dated December 18, 2000, you state that the organization has 28 regular members whose annual dues is \$135.00. There are 40 temporary members whose annual dues is \$220.00. The temporary members are members who enjoy full membership benefits from year to year (on annual basis) but who have no capital contributions or long-term commitment to the organization. The difference in annual dues is based on typically greater pool facility usage by temporary members and that fact that such members did not contribute capital to create the pool facility. Such equitable distinctions and their somewhat more transient nature are why the temporary members do not enjoy voting privileges.

Letter dated April 9, 2001, disclosed that: You do not keep any records as to how much of your income is paid by temporary members, regular members or the member's guest for your events. The only other income associated with the regular members is the admissions fees. To the best of your knowledge, no "fees" other than the dues of \$220.00 for temporary members, \$135.00 for regular members and the admissions to the three parties have been assessed or collected. You are uncertain [REDACTED] was granted a special or honorary membership because [REDACTED] deceased and all of the initial directors are deceased except for [REDACTED]. You do not have records of the last 50 years to substantiate your income and expenditures.

Your stockholder meeting of April 20, 1998 states: "Information before 1983 was hard to find. Another bothersome point is that stockholder pay one amount in dues and summer members pay more. If anything happened to the pool, assessment goes back to the members. These summer members really subsidized paying of the debt service."

Section 501 (c)(7) of the Internal Revenue Code provides for exemption for clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides that, in general, this exemption extends to social and recreational clubs, which is supported solely by membership fees and assessments. A club which engages in business, such as making its social and recreational facilities available to the general public or selling products and merchandise is not organized and operated exclusively for pleasure and recreational purposes.

Section 1.501(c)(7) of the Income Tax Regulations provides as follows:

a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs, which is supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenues from members through the use of club facilities or in connection with club activities.

b) A club which engages in business, such as making its social and recreational facilities available to the general public - is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Public Law 94-568 as explained in Senate Report No. 94-1318, published in Cumulative Bulletin 1976-2, page 597, provides that a club, exempt from taxation and described in section 501(c)(7), is permitted to receive up to 35 percent of its gross receipts from a combination of investment income and receipts from nonmember use of its facilities or services, so long as the latter does not represent more than 15 percent of the total receipts. It is further stated that if an organization exceeds these limits, all of the facts and circumstances must be considered in determining whether the organization qualifies for exempt status.

Revenue Procedure 71-17, published in Cumulative Bulletin 1971-1, page 683, establishes record keeping requirements for social clubs, to separate nonmember income. If these requirements are met, certain presumptions as to member vs. nonmember income may be made, as outlined in the Revenue Procedure.

Revenue Ruling 58-588 published in Cumulative Bulletin 1958-2, on page 265, states an organization formed by several individuals to operate a health, recreational, and social club but whose predominant activity is selling of services for profit to an unlimited number of so-called "members", who have no voice in the management of the club and whose only rights are the use of the club's facilities upon payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Internal Revenue Code.

Revenue Ruling 58-589, published in Cumulative Bulletin 1958-2, on page 266, holds that a club will not be denied exemption merely because it receives income from the general public; that is, persons other than members and their bona fide guests, or because the general public on occasion is permitted to participate in its affairs, provided such participation is incidental to or in furtherance of its general club purposes and it may not be said that income therefrom is inuring to members. This is generally true where the receipts from nonmembers are not more than enough to pay their share of the expenses.

Revenue Ruling 70-48, published in Cumulative Bulletin 1970-1, on page 133, holds that a social club whose active members pay substantially lower dues and initiation fees than associate members, although both classes enjoy the rights and privileges in the club facilities, does not qualify for exemption under section 501(c)(7) of the Code.

Based upon the facts within your case, we have determined that you do not operate within the purview of 501(c)(7) of the Internal Revenue Code.

ISSUE - 1 CLASS OF MEMBERS

IRC 501(c)(7) permits social clubs to have more than one class of membership, such as, regular, associate, corporation-sponsored and corporate. However, when the classes of members have no voting rights or have no voice in the management of the club it must be determined whether those individuals are bona fide members.

A review your application and accompanying documents disclosed that you have two classes of members, regular and temporary. Your temporary members are individuals who have use of your pool facility during the summer with the same privileges as regular members. They do not have voting rights and can not constitute a quorum. Although you are not selling services for a profit as in Revenue Ruling 58-588, you are soliciting non-voting members to offset the expense of maintaining the pool. You indicated that temporary members are limited to 40. There is no "limit" on the number of members that would constitute doing business with the general public. Your "temporary members" are seasonal visitors and permitted membership on an annual basis. The regular members determine whether or not the temporary members can continue his or her membership for the next year based upon a quorum vote. A quorum could be 3 to 28 persons during a meeting. Therefore continued membership is based upon the "whim" of voting members. Based upon the lack of control or involvement of your temporary members in the club, we hold that they are not bona fide members.

You are not like the organization described in Revenue Ruling 58-589 because your temporary members' participation is not incidental but reciprocal. In addition, the income received from your temporary members far exceeds their share of expenses. This fact is reiterate by the statement in your minutes, "These summer members really subsidized paying of the debt service."

ISSUE - 2 RECORDKEEPING

Your correspondence disclosed that your organization does not have adequate or accurate records of income received from both classes of members. Nor have you maintained records of the income received from your non-voting members and their guest, thus you have failed to meet the requirements of Revenue Procedure 71-17.

ISSUE - 3 INUREMENT

Evidence in your application upholds the fact that the income received from temporary members (non-members) primarily supports the club.

Your letter dated July 26, 2001, references Pittsburgh Press Club v. United States as your basis for exemption. You indicated that the "temporary member" income was de minimis because of initial capital contributions of between \$1,000 and \$1,500. In the cited court case the nonmember income was determined to be between 11 to 17 percent and dealt with the taxable years prior to the enactment of P.L. 94-568. P.L. 94-568 changed the language of IRC 501(c)(7) from "exclusively" to "substantially all" and permits 15 percent of a clubs gross income to be derived from non-members. The non-members income of your organization, based upon the financial data submitted, is 41 to 51 percent.

You indicated in your correspondence that we disregarded or ignored your reference to the above initial capital contributions. Declarations within your correspondence and your financial data belie your statement of "initial capital contributions". Those declarations are as follows:

- ❖ The only other income associated with the regular members is the admissions fees. To the best of your knowledge, no "fees" other than the dues of \$220.00 for temporary members, \$135.00 for regular members and the admissions to the three parties have been assessed or collected.
- ❖ Information before 1983 was hard to find.
- ❖ We believe that such tax returns would show, if the records were available, which they are not, that the expenses.....

Social clubs are primarily supported by their member's payments. Thus, the exemption of social clubs is based on the logic of allowing members to pool their funds for recreational purposes, rather than by any compelling public benefit conferred by social clubs. Your club currently charges temporary members eighty-five dollars more annually than voting members. Increase in dues of voting and non-voting members is determined by the voting members. Temporary members have no say in any increase to their dues, assessment and/or fees which factually limits their "privileges".

We hold that the income received from "temporary members" and their guest is nonmember income, which inures to the benefit of your regular members. You are like the organization described in Revenue Ruling 70-48. While your organization does have a "large number" of members in each class, the fact that the benefits conveyed may be relatively small does not change the basic element of potential impermissible inurement. "Spokane Motorcycle Club vs U.S." Your organization relies heavily upon the dues/assessment fees paid by non-voting members for operations. Thus they are relieving the members of their financial responsibility.

Therefore, we have concluded that you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(7) of the Code. In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office. If you will be represented by someone who is not one of your principal officers, that person will need to file a power of attorney or tax authorization with us.

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination on this matter.

If you agree with this determination, please sign, date and return the enclosed Form 6018.


Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Steven T. Miller

Steven T. Miller
Director, Exempt Organizations


Enclosure: Publication 892
Form 6018